Law and Social Norms in Contractual Relationships

Juurikkala, Oskari

2009

Juurikkala , O 2009 , ' Law and Social Norms in Contractual Relationships ' , Helsinki Law Review , vol. 3 , no. 1 , pp. 49-67 . < https://journal.fi/helsinkilawreview/article/view/74243 >

http://hdl.handle.net/10138/316049

publishedVersion

Helsinki Law Review 2009 p. 49–67

Law and Social Norms in Contractual Relationships

Keywords: Contract Law, Social Norms, Informal Business Practices, Efficiency of Legislation

Oskari Juurikkala[1]

Abstract

Law is important – but not as important as many lawyers believe. Evidence from different countries demonstrates that businessmen rely more on social norms than on legal rights and duties. Sometimes law is even deliberately avoided. Social norms and informal practices can also be enforced through a variety of non-legal sanctions. Law is still relevant, especially in non-continuous relationships and so-called end-game situations. But legal norms are most relevant and efficient when they are well-aligned with social norms.

Full Article

1 Introduction

It seems to be a universal phenomenon among human beings that we overvalue our own field of interest and expertise, and undervalue that with which we are less knowledgeable and comfortable. The present article challenges that *legal centralism* of lawyers and legal scholars by showing that, in ordinary life, law plays a role that is entirely secondary to a range of social norms that govern human relationships.

There is a burgeoning academic literature on law and social norms.[2] This article focuses on the role of legal and social norms in the governance of contractual relationships. The first part reviews two empirical studies which look at business practices in two sample countries, the United States and

1 LL.B. (English Law), M.Sc. (Economics). Financial support from the Emil Aaltonen Foundation and the Acton Institute are gratefully acknowledged.

2 The theme is certainly not a new one, but recent years have evidenced an increasing theoretical interest in the relationship between these phenomena, especially in Law and Economics. Mercuro and Medema 2006, chapter 7, is a good introduction. Ellickson 1991 is almost a modern classic which helped to inspire interest in the topic. More recently, several journals have hosted special issues on this topic.

Taiwan. The second part examines different theories about the relationship between social norms and law. The third part discusses some of the implications and challenges of the theory.

2 Empirical Evidence on Legal and Social Norms in Business Relationships

2.1 Non-contractual Business Relationships in the United States

Stewart Macaulay's classic article "Non-Contractual Relations in Business" is a fascinating empirical investigation of the contrasting roles of legal and non-legal norms in business.[3] The study was based on interviews with businessmen and lawyers of firms based in Wisconsin, USA. In the following, I summarize some of the key findings of that study. Although they may be obvious to many businessmen, they are equally surprising – perhaps even shocking – to many lawyers and law students.

Firstly, there is the issue of general attitudes. A lawyer might presume that law has a central place in business relationships. Not necessarily so, says Macaulay. He found that most businessmen claim they prefer a handshake or "a man's word" to legal contracts, despite the fact that their lawyers expressly disapprove of their attitude. For businessmen, "let's do the deal" means defining only broadly what is to be done and what the price will be – specific legal contracts are a secondary matter.

Secondly, the study discovered that many contracts might be legally unenforceable – and businessmen do not necessarily see this as a major issue. It often happens that both parties include their standard forms into their communications, thereby trying to insert those conditions into the contract. This so-called "battle of the forms" means that sometimes there is no clear agreement on which party's standard form governs the relationship, and consequently there may be no contract at all (for lack of acceptance) or its terms may be open to question. Macaulay adds that the companies in the investigation not infrequently made "requirements contracts" (i.e., contracts to supply a firm's requirements of an item rather than a definite

3 Macaulay 1963.

quantity), which were probably unenforceable under Wisconsin law at the time; however, "none [of the businessmen] thought that the lack of legal sanctions made any difference."[4]

Thirdly, businessmen were found to shun legal disputes. As a matter of fact, many contracts were well negotiated and planned, but even then disputes were rarely based on the strict legal obligations; flexible adjustments to legal rights were common. An example is the cancellation of orders: in law, the seller would be entitled to demand full payment, but actually cancellations were commonly accepted without complaints. As one lawyer explained:

> "Often businessmen do not feel they have "a contract" – rather they have "an order." They speak of "canceling the order" rather than "breaching our contract." When I began practice I referred to order cancellations as breaches of contract, but my clients objected since they do not think of cancellation as wrong. Most clients, in heavy industry at least, believe that there is a right to cancel as part of the buyer-seller relationship. There is a widespread attitude that one can back out of any deal within some very vague limits. Lawyers are often surprised by this attitude."[5]

Consequently, lawsuits seemed to be extremely rare in comparison to the number of disputes that arise. One purchasing agent said: "If something comes up, you get the other man on the telephone and deal with the problem. You don't read legalistic contract clauses at each other if you ever want to do business again. One doesn't run to lawyers if he wants to stay in business because one must behave decently."[6]

One may ask how universally applicable the findings of this study would be across different industries, countries and types of business. Nevertheless, the evidence in Macaulay's study reveals a fundamental gap between the *legal centralism* of most lawyers and the pragmatic *anti-legalism* of most businessmen.

4 Ibid., p. 60.
5 Ibid., p. 61.
6 Ibid.

2.2 Informal Business Practices in Taiwan

Social norms may be more important than law in other contexts too, as *Jane Winn* demonstrates in her interesting theoretical and empirical study of small business practices in Taiwan.[7] The author notes that the ”economic miracle” of Taiwan after the 1960s is usually attributed to the legal and institutional reforms made by the Taiwanese government – reforms which boosted foreign investments and export industries. Winn argues that this account of Taiwan's economic history does not reflect the reality of domestic business. It has been estimated that more than 50% of all economic activity in Taiwan is conducted not just domestically, but also in the ”informal sector”, that is, outside ordinary legal relationships.

Winn studied Taiwanese business practices through a range of interviews with lawyers, judges, business people, government officials and even some members of criminal gangs. She found strong support for the commonly held belief that in Chinese society, the authority of the law is relatively weak, whereas relations and connections have a normative role above that of formal legal rules. The roots of this setting can be found in traditional Chinese culture: according to the Confucian ideal, human relationships and rituals are the basis for cooperative relationships, while the function of the law is limited to that of inflicting punishments in cases of social misconduct. Thus law plays a secondary role, reinforcing the primary social reality, which pre-exists above legal rules and operates mostly in ignorance of formal law. Winn argues that although values may be changing, this attitude towards law is still reflected in present-day Taiwan – even among lawyers.

Winn depicts the Chinese relational system as follows: in Chinese culture, the “self” is primarily constituted by relationships, especially family relationships. Beyond family ties, connections (*guanxi*) are of central importance. The term refers to something more than ”networking” in Western societies: *guanxi* relations are forged through repeated dealings where there are strong unwritten rules of reciprocity such as doing favors, maintaining ”face” etc. An important point is that, according to the author, dealing with strangers is considered problematic and even dangerous.

7 Winn 1994.

Winn however argues that the traditional culture is not the only reason for the marginal role of the law. Law is considered oppressive partly because of the authoritarian political reality of Kuomintang rule – an authoritarianism that extended to the legal system. Taiwanese legislation is considered "labyrinthine", rigidly formalistic and often incompatible with social realities.[8] The law is often tied to politics through the so-called "exercise of official discretion". For example, gross violations of law might be tolerated for long periods of time, but selective enforcement of laws may be employed to harass political dissidents.[9]

On the empirical level, Winn's study focuses on small businesses. One example is tax evasion, which seems to be common among Taiwanese small enterprises. Tax evasion is often done through misreporting, for example by using multiple account books (a practice that seems to be widespread in other countries too, such as Russia). The author says that many legal measures have been implemented to fight against these practices, but the effect has been questionable. The role of social norms is crucial: successful tax evasion requires the cooperation of many individuals, including accountants and some tax officials. Cooperation is possible due to the fact that relational obligations are considered normatively superior to legal obligations, and because public authorities are widely seen as lacking full legitimacy.

Winn also found that business dealings among small businesses are usually done without formal contracts. One consequence of this is that organized crime has gained an important role in the society, because it plays "a significant role in policing transactions in the informal sector."[10] Whether this is an efficient solution is a separate issue; in any case, it does seem that criminal gangs can provide necessary assistance for debt collection. Some gangsters even have business cards in which they are represented as officers of companies offering dispute resolution and debt collection.

Why then are formal contracts avoided? Winn's interviewees said that courts are often seen as unhelpful, because they follow rigid rules and require formal documentation, which may be lacking. Moreover, even if one succeeds

8 Winn 1994, p. 203.
9 Ibid., p. 202.
10 Ibid., p. 209.

in obtaining a favorable judgment, it can be difficult to locate the assets of the debtor due to complex family ownership structures and dubious accounting practices. In such an institutional setting, a real but controlled threat by gang members can induce the debtor to use his *guanxi* to find the means to honor the debt.

The face of informal business in Taiwan reveals a different picture of the relationship between law and social norms – a picture that seems to be tied to the cultural and political history of the country and its people. Note, however, that Winn's findings may be widely applicable in a range of less developed countries such as India, or countries in Africa and Latin America.[11]

3 Different Relationships Between Law and Social Norms

3.1 Non-legal Sanctions

The empirical findings reviewed above demonstrate that the relevance of social norms is more than a mere sociological moot point. The more challenging question concerns how the relationship between law and social norms should be framed theoretically. In the following sections I review some of the key discussions and arguments on the role of non-legal sanctions, the different uses of law, and debates concerning the efficiency of law and social norms.

One way to look at the issue is to distinguish between legal and non-legal sanctioning mechanisms.[12] An interesting investigation on this has been made by *David Charny*, who investigates different types of commitments and sanctions that may govern commercial relationships.[13] He notes that there are at least three different types of non-legal sanctions.

11 See for example the discussion on "informal trade" in de Soto's 1989 work on extra-legal or "underground" economic activity in Peru.

12 The role of sanctions plays a central role in Anglo-American legal thought, because traditional English legal positivism tended to view laws as mere "commands backed by sanctions". Continental European legal theory is different in its emphasis on law as a normative system. This is also reflected in terminology: in the United States, legal scholars often use "norms" as a short-hand for social norms; in contrast, Finnish lawyers use the word "norms" to refer to legal norms.

13 Charny 1990. See also Panther 2000 for a review of related literature.

Firstly, there are "*bonds*" between the parties themselves. These may take the form of "relationship-specific prospective advantages", such as relation-specific investments, which pay considerably less outside the present relation. In repeated-deal situations, the loss of trust also creates high indirect economic costs.

Secondly, Charny refers to *reputation* among market participants (potential transactors) as a basis for non-legal sanctions. He notes that reputation is important not only in business-to-business markets but also in consumer goods markets. For example, the existence of brand value increases the cost of losing a good reputation, thereby giving strong non-legal incentives to behave fairly. An important issue with regard to the effectiveness of this type of sanction is the dissemination of information to other market participants. One reason why some markets (e.g., lawyers, doctors, financial advisors) may require heavier legal regulation is that many clients in these markets are inexperienced or infrequent buyers of the services and will find it difficult to assess the objective reputation of service providers.

Thirdly, there are *internal sanctions*, which Charny calls loss of "psychic and social goods." He notes that companies often try to encourage valuable internal sanctions by creating strong "corporate cultures" so that employees become emotionally attached to their firm, wanting to behave loyally and regretting if they must change jobs. In support of this theory, one should mention the work of *Bruno Frey*.[14] Building on extensive empirical work in motivational psychology, Frey shows that increasing monitoring and external incentives does not always have the desired effect on work effort, because external incentives can in some circumstances negatively shape the internal attitudes of trust, loyalty and working for the honor of doing a good job. This can easily be applied to business relationships: trust and loyalty are key ingredients of successful business, and that must be taken into account in contract negotiating.

Charny also argues that firm-employee relations are strongly influenced by non-legal incentives and sanctions – and this is true both ways. There are various sanctions, which may include relationship-specific prospective ad-

14 Frey 1993, 1997.

vantages, reputational concerns and internal sanctions. That may explain why parties often pay so little attention to the formal details of employment contracts in the employment process, and not infrequently there is no written contract of employment. Prudent employees (and employers) should of course check that there are no onerous contract terms, but many important discussions, agreements and expectations are routinely left outside the written contract of employment.

Macaulay's empirical evidence is consistent with the preceding framework. He shows that most of business is quite possible without enforceable contracts, given the existence and strength of various social norms that support business relationships. For example: it is unpleasant for company personnel if things are not done right with business partners, so it is better to act in accordance with agreements; salesmen often know purchasing agents well, give mutual favors, go to dinner together etc. Top executives often belong to similar societies and clubs, the likelihood of future business forces companies to maintain a good reputation and failure to pay would result in blacklisting, negative gossip and the like.

Macaulay's evidence also shows that businessmen think that negotiating detailed contracts can harm good relationships, and talking about remote contingencies can result in losing the deal. Frey's theory of intrinsic motivation seems to apply too: The businessmen Macaulay studied had learnt that if you make a detailed contract, you only receive according to the letter of the contract; but if you build relationships of trust, people are more flexible, even generous. Negotiating too many details indicates lack of trust, and may result in a loss of flexibility. Vague obligations may actually work better than precise ones (even though lawyers hate vague obligations), because it is easier to renegotiate them in light of the actual circumstances which may be impossible to predict. Finally, threatening to take things to a lawyer can be dangerous, because by doing so one can insult the other party, who in consequence will retaliate and may refuse to negotiate peacefully. When this happens, the loss of time and money may escalate.

3.2 The Uses and Abuses of Law

The empirical evidence reviewed earlier showed that law is in some contexts less important than many lawyers think. The theory of non-legal sanctions also reveals that legal sanctions play only a minor role in many contexts. This raises some obvious questions: why does law matter at all? Why do businessmen write contracts if they prefer not to rely on them? Is law more important in some contexts than in others?

Charny lists several reasons why commercial contracting parties prefer to rely on non-legal commitments: the costs of drafting can be high; it is difficult to know all contingencies in advance and to weigh their likelihood; informality can help to nurture trust between the parties, etc. On the other hand, legal proceedings are relevant in some circumstances, even though they are generally seen as the most costly and unpleasant dispute resolution mechanism. Sometimes the success of informal negotiations also requires the backing of at least a theoretical threat of going to court. Thus to neglect law altogether would be to miss the full picture and throw the baby out with the bathwater.

Macaulay's empirical findings support this view. The businessmen interviewed said that contracts are sometimes necessary, for example when there are clear risks that must be provided for. Litigation may also be worth the money and time in some special cases. But there are also some surprising reasons to make written and even detailed contracts. For example, saying "I'll have my lawyer review it" can be used as a delaying tactic, whereby one keeps the negotiations alive while still looking around for alternatives without committing oneself. In large companies, detailed contracts may also be used for internal communication, because they specify the relevant details to production departments, accountants etc.

Yet there is more to it, as *Lisa Bernstein's* insightful paper demonstrates.[15] She observes that there are many reasons why trading partners may actually prefer some aspects of their agreements and relationships to be legally unenforceable. Commercial customs and social norms allow business transactors

15 Bernstein 1996.

to modify written contract terms for a range of potential non-legal reasons. Bernstein poses the question of why businessmen do not incorporate all of these factors into the express agreement. She answers by pointing out three potential difficulties.

Firstly, there are *signaling effects*. Negotiating remote contingencies into the contract may be inappropriate, because it may signal distrust or unusual desire to litigate. Or, as was said earlier, one may fear that it would make things too inflexible if circumstances change. Secondly, there are *legal system costs*. Legal system costs refer to litigation costs, delays, and the risk of judicial error. Because of these costs, commercial transactors want to avoid unnecessary litigation. A good example given by Bernstein is the software industry: it is usual to disclaim all legal warranties, but at the same time to promise (in legally unenforceable ways) to fix defective products. The apparent inconsistency is explained by one expert as follows: software companies fear that some customers will initiate unreasonable litigation, and software suits are always very expensive to defend and could ruin the business. Finally, there is a difference between *observable and verifiable information*. Although many relevant factors can be observed by the transacting parties, they may not be verified by a third party. This is true of complex software cases, as mentioned. Bernstein also says that when businessmen are forging new relationships, it is difficult to know the trustworthiness of the other party. Trustworthiness can be observed later on, but it cannot be measured and verified in a legally enforceable way. Thus it can be better to have a strict written contract in case the other party turns out to be untrustworthy, but otherwise to govern the relationship with a more flexible relational agreement.

Bernstein proposes an interesting distinction that makes more sense of the interplay between law and social norms. She differentiates between what she calls (a) *relationship-preserving norms* and (b) *end-game norms*. Relationship-preserving norms are flexible and easily adjustable, and they facilitate cooperative dispute resolution. End-game norms, in contrast, govern the relationship when the parties do not intend to do business again, and therefore the norms are strict and clear. Bernstein believes that commercial parties will rationally want to separate these two types of norms: end-game norms should not be available when the cooperative business relationship

is alive and well, given the limitations of contractual and law-based rules. In contrast, it is good to have those end-game norms in place in case the relationship goes sour; thus neither party can abuse the cooperative nature of relationship-preserving norms.

Macaulay's evidence is broadly consistent with Bernstein's theory, and we need not recite it again. Bernstein provides addition empirical support for her hypothesis. She provides a detailed description of the National Grain and Feed Association's (NGFA) membership arbitration system, which is composed of industry experts. On the one hand, NGFA practices are very flexible when cooperation is ongoing, but when things go to arbitration, the tribunal sticks to the written contracts – and the members prefer it this way. For example, relationship-preserving norms in NGFA usually "split the difference," whereas arbitration proceedings do not, and Bernstein's interviews confirm that this is what NGFA members prefer. Written contracts also often specify the use of official weights, but because this is expensive, in-house weights are accepted in practice; however if it turns that the other party may have been cheating, one can rely on the written terms of the contract and demand compensation. Thus untrustworthy businessmen cannot abuse the cooperative and flexible norms and customs which normally govern NGFA trade.

3.3 Law, Social Norms and Efficiency

One of the big debates concerning social norms and law is their relative – and mutual – efficiency in governing contractual (and other) relationships. The first thing to note is that law is certainly not irrelevant. *Hernando de Soto* explains how the lack of legal contract enforcement impedes business in the informal economy of Peru.[16] When business is conducted without legal permits, businessmen are forced to rely on a range of non-legal mechanisms to mitigate lack of legal enforcement. For example, they cultivate long-term friendships; avoid large deals with individuals trading partners; invest time in investigating and monitoring the other party; or deal only with relatives or people from the same region. Sometimes the informal communities even

16 De Soto 1989, chapter 5.

organize collective dispute resolution bodies, and violence (or threats) may be used as a last alternative.

The difference between the informal economy in Peru and business in Europe and United States is one of degree only. Nevertheless, it seems implausible to say that social norms are enough without law. Indeed, de Soto's analysis of the underground economy in Peru reveals that when the law is not available, people resort to mechanisms which imitate the judicial and policing powers of the state, thereby creating quasi-states within the state.

The question that remains concerns the optimal role and importance of law vis-à-vis informal social norms. *Robert Cooter* posits that legal and social norms do their job most efficiently when they are well *aligned together*, such that they support each other.[17] The idea is not that law and social norms should mirror each other, but that they should complement each other. Cooter explains:

> "In a developing economy with relatively free trade, business will tend to develop efficient norms to regulate private interactions. In these circumstances, the role of state law can be limited to correcting failures in the market for norms. Failures tend to occur because private, informal punishment insufficiently deters wrongdoing. In these circumstances, state enforcement of social norms can increase private cooperation and production. However, successful state enforcement typically requires a close alignment of law with morality, so state officials enjoy informal support from private persons."[18]

The challenge seems to be that of finding the right balance and mixture between social norms and law. Without any law, the "law of the jungle" may prevail, but over-legalization and over-regulation are also harmful.[19] According to Cooter, legal centralism – and consequent over-regulation – is one of the reasons why law and social norms get out of alignment.

17 Cooter 2000.
18 Ibid., pp. 243–244.
19 See for example Pildes 1996.

However, not all legal scholars are as enthusiastic as Cooter about social norms. In his classic work *The Concept of Law*, *H.L.A. Hart* drew the distinction between law and custom.[20] He defined law as a union of "primary rules" (which control people and behavior) and "secondary rules" (which control the application and amendment of rules). Custom, according to Hart, does not have secondary rules, and as a consequence, it is inflexible and not under anyone's rational control. Thus, it would seem, law can be used to reform unworkable or old-fashioned social norms. In a more recent paper, *Eric Posner* gives a general critique of the idea that social norms are inherently more efficient than legal rules.[21] The basic point is similar to Hart's: social norms may not be so rational, and law can improve the situation by regulating behavior rationally and by providing more systematic sets of rules.

Posner is surely right: it would be senseless to say that law has no role to play in shaping and complementing social norms. However, it is hard to say where to draw the line. It can be difficult to say exactly when social norms are working well enough and when law should play a more important role. The dire consequences of over-legalization of the society are probably only seen after many years. Moreover, in many cases law cannot easily amend unworkable or harmful social norms. Take the case of Taiwan[22], or almost any "developing" country: there is a strong path-dependency and interaction between formal and informal institutions.

There are additional reasons to be cautious. Robert Cooter argues in an earlier paper, quite surprisingly, that sometimes it is easier to change custom than to change law.[23] Law depends on political processes, which entail costly procedures and special interests; custom depends on social consensus, which can be more flexible in some circumstances. Cooter goes so far as to say that "Hart's critique of custom resembles a socialist's critique of markets"[24]. There may be more to that argument than meets the eye: *David Charny* believes that methodological commitments influence one's attitude toward social

20 Hart 1961.
21 Posner 1996.
22 See Winn 1994.
23 Cooter 1996.
24 Ibid., p. 1655.

norms.[25] On the one hand, there is the neoclassical tradition of economics, which highlights market failures and largely believes in government's ability to improve matters efficiently. On the other hand, the Hayekian tradition shows that imperfect information makes central planning difficult if not impossible, whereas the analysis of decentralized coordination demonstrates that markets are not so irrational after all.

However, Charny is skeptical about the entire project of "normative analysis" of social norms and law. As he puts it: "There are simply too many unobservable variables, particularly those that bear on the 'noneconomic' motivations and preferences that must play a role in the start-up and the effectiveness of complex sanctioning systems."[26] Therefore it may be better to focus on trying to understand these phenomena and avoid arguing in terms of arm-chair generalities.

4 Implications and Challenges

The theory of law and social norms presents a host of interesting implications and directions for further research. For example, one fashionable topic in economics today is the theory of *incomplete contracts*.[27] According to this strand of research, contracts never specify all the possible contingencies and the responses to them. Reasons for this include that it is impossible to predict and calculate the probability of certain contingencies, while it is often impracticable and expensive to negotiate on them. The theory of incomplete contracts emphasizes the allocation of property rights as a way of dealing with contractual incompleteness: ownership rights function as the residual for whatever is not included in the contract. However, the theory and evidence of social norms shows that the standard analysis of incomplete contracts is plainly misleading: contracts do not exist in a normative vacuum. There are other norms that facilitate cooperation in the absence of contractually agreed provisions. Moreover, businessmen often prefer informal governance of relationships to legal and contractual planning. The

25 Charny 1996.
26 Ibid., p. 1858.
27 See Oliver Hart 1995, Salanié 1997.

theory of social norms therefore challenges the background assumptions of the economic theory of incomplete contracts.

The relationship between legal and social norms is important for practical reasons too. For example, Cooter notes that unproductive and uncooperative behavior can sometimes be prevented through private enforcement.[28] In practice, public enforcement through law may be necessary, but legal enforcement is expensive, and it is important that it is complemented by social norms which punish antisocial behavior. On the other hand, law plays an important role in influencing social norms, because law has an expressive function: laws relating to environmental regulation, tobacco smoking, drug use etc. can have powerful effects on public perceptions and expectations.[29]

Understanding the role of social norms may be especially important for policy-making in developing countries. Mainstream development economics emphasizes institutional reform, but this is understood in the context of formal institutions: electoral systems, law courts, the regulation of police, enforcement of contracts and private property, etc. These are all important issues, but often the question remains: how to achieve all of that in practice? Legal transplants from Western countries do not necessarily produce the desired effects, because the social norms and informal institutions can be very different. *Edgardo Buscaglia* argues that, without the alignment of legal and social norms, one does not get compliance and efficiency.[30] IPR protection in China provides a topical example: although the central government seems to be making an effort to enforce Western-style patents and copyrights, the practice in regional courts and other public instances can be different, because Chinese attitudes towards Western rights and privileges are influenced by many factors other than formal legal provisions alone.[31]

28 Cooter 2000.
29 Cooter 2000 gives an amusing example. A new law in California requires dog-walkers to clean up the poop. Earlier, people did not complain much about dog poop, but after the new law, they do if someone breaks the law. It is easier to say "obey the law" than "don't be so rude." This is understandable: when a standard of behavior is included in the law, it has the moral backing of the legitimate public authorities of the community.
30 Buscaglia 2000.
31 See for example Fung 1996 and Allison and Lin 1999.

However, much work remains to be done before full enlightenment. Some authors have noted the need for a more consistent and holistic theory of norms. The greatest challenge seems to be that of making sense of the internal (or subjective) dimension while uniting it to the external (or objective) dimension of norms. In his influential work, *Douglass C. North* has argued that the biggest challenge in creating good social and political institutions is how to create the conditions for just government and law enforcement. Formal political constitutions seem to make relatively little difference empirically speaking, and North therefore believes that internal norms are central to our understanding of this issue, but we do not seem to have any consensus on what they are and how they are formed and shaped.[32]

Lawrence Mitchell criticizes the new "norms jurisprudence" for accepting too much of the behavioral and positivistic attitude of modern social science and especially economics. He argues that the approach taken by the leading authors ends up distorting instead of improving the explanation of norms, because they "generally share the same basic goal, which is to establish a non-normative theory of norms. [...] They tend to share an underlying metanorm of efficient wealth or welfare maximization, and all share the basic belief that people are motivated principally—if not solely—by self-interest. Most important, by limiting their inquiry to what they see, they are unable to explain, except at the most superficial level, how norms become normative—that is, how they come to tell us what we ought (or ought not) to do."[33]

5 Conclusions

This article has reviewed some of the empirical and theoretical literature on social norms and law. It would be interesting to see some discussion – and investigation – of their relationships in Finnish society and business practice.[34] Given the enormous importance of non-legal norms and governance mechanisms in contractual relationships, it might also not be entirely

32 See North 1990.
33 Mitchell 1999, pp. 208–209.
34 A step in this direction is taken in Nystén-Haarala 1998.

unwise to put more importance to them in legal education. As *Alexis de Tocqueville* once mused: "Laws are always unsteady when unsupported by mores; mores are the only tough and durable power in a nation."[35]

35 Cited in Gregg 2003, p. 54.

Bibliography

Allison, John R. and Lianlian Lin: The Evolution of Chinese Attitudes Toward Property Rights in Invention and Discovery. 20 University of Pennsylvania Journal of International Economic Law 1999, pp. 735–792.

Bernstein, Lisa: Merchant Law in a Merchant Court: Rethinking the Code's Search for Immanent Business Norms. 144 University of Pennsylvania Law Review 1996, pp. 1765–1823.

Buscaglia, Edgardo: Law and Economics of Development. In Boudewijn Bouckaert and Gerrit De Geest (eds.), Encyclopedia of Law and Economics, Volume I. The History and Methodology of Law and Economics. Edward Elgar, Cheltenham 2000, pp. 562–602.

Charny, David: Nonlegal Sanctions in Commercial Relationships. 104 Harvard Law Review 1990, pp. 375–467.

Charny, David: Illusions of a Spontaneous Order: "Norms" in Contractual Relations. 144 University of Pennsylvania Law Review 1996, pp. 1841–1858.

Cooter, Robert: Decentralized Law for a Complex Economy: The Structural Approach to Adjudicating the New Law Merchant. 144 University of Pennsylvania Law Review 1996, pp. 1644–1696.

Cooter, Robert D: Law from Order: Economic Development and the Jurisprudence of Social Norms. In Mancur Olson and Satu Kähkönen (eds.), A Not-so-dismal Science: A Broader View of Economies and Societies. Oxford University Press, Oxford 2000, pp. 228–244.

de Soto, Hernando: The Other Path. Harper and Row, New York 1989.

Ellickson, Robert: Order without Law: How Neighbors Settle Disputes. Harvard University Press, Cambridge 1991.

Frey, Bruno S.: Does Monitoring Increase Work Effort? The Rivalry with Trust and Loyalty. 31 Economic Enquiry 1993, pp. 663–670.

Frey, Bruno S.: Not Just For the Money: An Economic Theory of Personal Motivation. Edward Elgar, Cheltenham 1997.

Fung, Jill Chiang: Can Mickey Mouse Prevail in the Court of the Monkey King? Enforcing Foreign Intellectual Property Rights in the People's Republic of China. 18 Loyola of Los Angeles International and Comparative Law Journal 1996, pp. 613–639.

Gregg, Samuel: On Ordered Liberty: A Treatise on the Free Society. Lexington Books, Lanham 2003.

Hart, H.L.A.: The Concept of Law. Oxford University Press, Oxford 1961.

Hart, Oliver: Firms, Contracts, and Financial Structure. Oxford University Press, Oxford 1995.

Macaulay, Stewart: Non-Contractual Relations in Business: A Preliminary Study. 28 American Sociological Review 1963, pp. 55–67.

Mercuro, Nicholas and Steven G. Medema: Economics and the Law, 2nd Ed. Princeton University Press, Princeton 2006.

Mitchell, Lawrence E.: Understanding Norms. 49 University of Toronto Law Journal 1999, pp. 177–248.

North, Douglass: Institutions, Institutional Change, and Economics Performance. Cambridge University Press, Cambridge 1990.

Nystén-Haarala, Soili: The Long-Term Contract: Contract Law and Contracting. Kauppakaari, Helsinki 1998.

Panther, Stephan: Nonlegal Sanctions. In Boudewijn Bouckaert and Gerrit De Geest (eds.), Encyclopedia of Law and Economics, Volume I. The History and Methodology of Law and Economics. Edward Elgar, Cheltenham 2000, pp. 999–1028.

Pildes, Richard H: The Destruction of Social Capital Through Law. 144 University of Pennsylvania Law Review 1996, pp. 2055–2077.

Posner, Eric A.: Law, Economics and Inefficient Norms. 144 University of Pennsylvania Law Review 1996, pp. 1697–1744.

Salanié, Bernard: The Economics of Contracts. MIT Press 1997.

Winn, Jane Kaufman: Relational Practices and the Marginalization of Law: Informal Financial Practices of Small Businesses in Taiwan. 28 Law and Society Review 1994, pp. 193–241.